A MIDDLE EASTERN MIRACLE? DEVELOPMENT POLICY LESSONS FROM EAST ASIA

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تقديم

يتشكك بعض المصريين فى إمكانية تحقيق رخاء اقتصادى، بل ويتندرون بالقول بأنه عندما سئل حاسب آلى خارق الذكاء عن موعد حلول هذا الرخاء فى مصر فإنه تجمد وتلعثم ولم يأت بأى جواب. ويزداد تندرهم عندما يوصف الرخاء الاقتصادى بشرق آسيا بأنه معجزة. وفى حقيقة الأمر أن قضية الرخاء الاقتصادى ليست مادة للتندر، فما تم إنجازه فى شرق آسيا ليس بمعجزة ولكنه حصاد سياسات الإصلاح التى صممها ونفذها البشر.

فى هذه المحاضرة يتعرض "جون بيج" الضوء على أهم محددات النمو السريع الذى حدث فى دول شرق آسيا. ويكشف عن مدى ملاءمة هذه المحددات لدول الشرق الأوسط مع التركيز على مصر. وويوضح أنهمن بين هذه الدول الشرق آسيويةهناك مجموعة تتميز بالأداء الاقتصادى المرتفع عن غيرها، كما أن هذه الدول مختلفة فيما بينها فى كثير من الحالات، بما فى ذلك النظام السياسى والاقتصادى، ولكنها تشترك فى بعض الخصائص الهامة للنمو. وعلى رأس هذه الخصائص: الاتفاق على استراتيجة واضحة تقتضى بالمشاركة فى مكاسب النمو، فضلاً عن تتبيها لسياسات تركز على تشجيع الصادرات وتقليص دور الحكومة، ودفع دور القطاع الخاصمن خلال الاهتمام بتعليم كل فئات السكان وخاصة تعليم الإناث.

وبتعرضه لكل خصائص وعناصر السياسات المتبعة فى دول شرق آسيا، فإن جون بيج يحل بعض الطلاسم المرتبطة بما يسمى بالمعجزة،ويؤكد على ان الطريق المؤدى للرخاء ليس مبهم وعند تلخيص للدروس المستفادة من التجربة الآسيوية وعلاقتها بالشرق الأوسط يؤكد بيجعلى أن التحدى الحقيقى أمام صانعى السياسة هو رسم الاستراتيجيات الملائمة والتى تشجع على إقتسام مكاسب النمو الاقتصادى. وقد قام بعض المشاركين بمناقشة جون بيج فى النتائج التى توصل إليها، وذهب بعضهم إلى أن منطقة الشرق الأوسط ليست منطقة متجانسة ولا تشترك فى القيم العقائدية والالتزام السياسى الذى تتمتع به دول شرق آسيا. وأشار البعض الآخر إلى الدور الذى لعبه النفط فى الشرق الأوسط، بينما شكك آخرون فى دور الحكومة كحكم محايد.

وكانت كل إجابات جون بيج تحمل رسالة مؤداها أنه بينما تلعب البيئة المحيطة برسم السياسات دوراً هاماً، إلا أن السايابسات الاقتصادية المتبعة فى شرق آسيا تشترك فى بعض الخصائص المتشابهة: منها مستوى ذو نوعية مرتفعة للكافة وتشجيع الصادرات وحكومة ذات حجم أصغر وقطاع خاص نشيط ومشاركة كافة الأطراف فى مكاسب النمو الاقتصادى وعلى الرغم من اتفاقه على تنويع الهياكل الاقتصادية فى دول الشرق الأوسط، إلا أنه يرى توجيهمسار السياسة فى دول الشرق الأوسط فى نفس الاتجاه الذى إتبعته دول شرق آسيا.

ويختتم بيج محاضرته بملاحظة إيجابية مؤداها أنه من الممكن أن تكون هناك "معجزة" شرق أوسطية خاصة وأن توزيع الدخل فى المنطقة أحسن حالاً من مناطق أخرى فى العالم، وأن المنطقة تتميز بالقرب من الأسواق الأوروبية، كما تتمتع بوفرة فى الأيدى العاملة المدربة. ويؤكد إن ما تحتاجه المنطقة فعلاً هو تركيز جهودها فى مجال رسم السياسات وتنفيذها.

د. أحمد جلال
المدير التنفيذى
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FOREWORD

Some Egyptians laugh at the prospect of econom ic prosperity in their country, and cite the joke about a super-intelligent computer that could predict the future. When this computer was asked about Egypt's economic growth outlook and timing, it simply froze in response. But poverty is no laughing matte r, and hearing about the East Asian miracle may compound despair, given that the age of miracles is over.

In this publication, John Page highlights the key ingredients of East Asia's 'fast growth, and explores their relevance for the Middle East in gener al, and Egypt in particular. He emphasizes the East Asia's high-performing economies are a divers group of countries that differ in many ways0including their political regimes and economic policies - but share several important characteristics. For most among these is a clear strategy of sharing the benefits of growth, along with a set of policies centered on promoting exports, reducing the size of government empowering the private sector through privatization and deregulation, and educating all population g roups—especially girls, By identifying features and policy components of East Asia's so -called "Miracle", Page unravels a few of the mysteries, and the road to prosperity is no longer opaque. Summing up East Asia's lessons for the Middle East, he stresses that the challenge for policy makers is to articulate appropriate strategies to promote shared growth.

John Page's conclusions about East Asia's lessons for the Middle East did not go unchallenged. Some participants argued that the region is not homogeneo us, nor does it share the cultural values or the political commitment of East Asia. Others emphasized the role of oil, or doubted the role of government as a referee. Each response from Page carried this message: While the environment in which policies are designed does matter, the economic practices adopted in East Asia had some similar features: quality education for all, export-friendliness, smaller government, active private sector involvement and shared benefits from growth. Notwithstanding the diversi ty of countries in the Middle East, a similar policy orientation is needed.

Page concludes on a positive note: 'There *can* be a Middle Eastern miracle.' That is so indeed, given that income distribution in the region is actually not as bad as in some other regions of the world. Moreover, the region is close to Europe's markets, and has abundant and skilled labor and an active commercial class. The missing link for regional prosperity is concerted effort on the policy front.

Ahmed Galal
Executive Director, ECES
November 1996

ABOUT THE SPEAKER

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John Page has had a long and distinguished career with the World Bank. His professional experience, in both research and practice, spans the globe and includes years of working in some of the world's most complex regions, most notably East Asia, Latin America, and the Middle East. Prior to his current position, Page was Senior Economic Advisor in the World Bank's Policy Research Depa rtment. Previously he was Division Chief of Operations for Latin America and the Caribbean. Page's work in industrial economics covers many countries, including Egypt.

As an authority on industrial economics, productivity and technological progress in dev eloping countries, Page has written and lectured extensively. He is the principal author of the widely -read book *The East Asian Miracle: Growth and Public Policy,* which was published in 1993, and *Peace and the Jordanian Economy,* published in 1994.

Before joining the World Bank, Page was on the faculty of Princeton University. He also taught at Stanford University, and was visiting professor at Johns Hopkins and Georgetown universities. Page was educated at Stanford and later obtained his doctorate from Oxf ord University.

PART I

A MIDDLE EASTERN MIRACLE?

DEVELOPMENT POLICY LESSONS FROM EAST ASIA

1. Introduction

East Asia has a remarkable record of high and sustained economic growth. From 1965 to 1995 its 23 economies grew faster than all other regions. Most of this achievement is attributable to seemingly miraculous growth in just eight high performing Asian economies (HPAEs)—Japan; the "four tigers": Hong Kong, Republic of Korea, Singapore, and Taiwan (China); and the three newly industrializing economies (NIEs) of Southeast Asia: Indonesia, Malaysia, and Thailand.[1] (Figure 1).

During the same period, the Middle East and North Africa (MENA) went from boom to bust. Between 1965 and 1985, its growth of per capita income was second only to the East Asian superstars. From 1985 to the present, the region's economic contraction has been larger than that of any other area except Africa. Individual countries in the region broadly mirror the region's aggregate performance (Figure 2). Tunisia and Morocco managed to maintain modest positive per capita income growth over the past decade. Egypt, which grew at East Asian rates until 1985, has stagnated since. Algeria, Jordan and Iran collapsed. Recently (since 1993) Jordan has succeeded in restoring growth; Algeria and Iran have not. The swing from boom to bust is the largest in the world. Not surprisingly, those concerned with restoring growth to the Middle East tend to look east in search of policy lessons from East Asia's success.[2]

The East Asian economies provide a wide range of policy frameworks, from Hong Kong's nearly complete laissez faire to the highly discretionary policy regimes of Japan and Korea. As a result, there are almost as many policy interpretations of East Asia's success as there are economists observing its

1 These eight High Performing Asian Economies (HPAEs) are the subject of the World Bank's study *The East Asian Miracle: Economic Growth and Public Policy* on which this essay draws. It also draws on Page (1994). The findings, interpretations and conclusions expressed in this paper are entirely those of the author. They do not represent the views of the World Bank, its Executive Directors, or the countries they represent.

2 The Middle East is not alone. Edwards (1995) describes the impact of East Asia's success on the formation of the "Latin American Consensus" on appropriate development policies.

Figure 1.
Past Growth Was Impressive, But Not Sustained

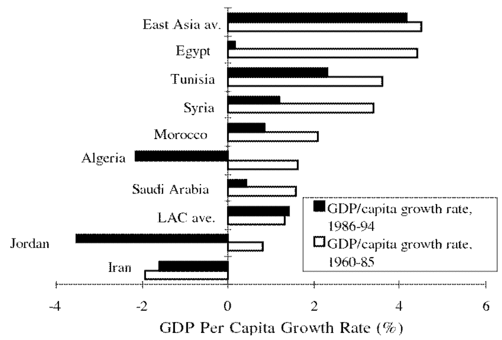
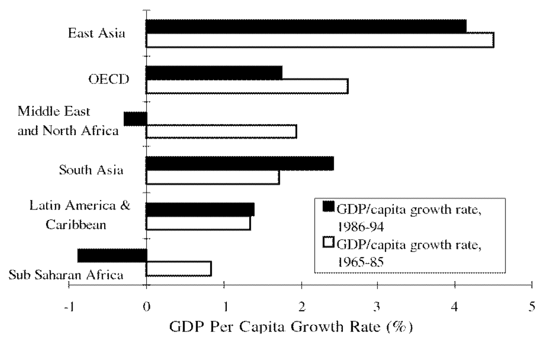


Figure 2.
Some Countries Have Succeeded While Others Have Not



Note: East Asia includes China, Hong Kong, Indonesia, Republic of Korea, Malaysia, the Philippines, Singapore, and Thailand. Latin America includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, and Venezuela. GDP growth rates are calculated as: [end year per capita GDP / beginning year per capita GDP]$^{1/\text{number of years}}$ - 1
Source: World Bank data.

economies. At one extreme, the coexistence of rapid growth and selective industrial policies in Japan, Korea, Taiwan (China) and Singapore has led some to argue that these economies were unusually successful at catching up technologically with the advanced economies. They attribute this success to activist government policies to alter industrial structure and promote technological learning, sometimes at the expense of static allocative efficiency. (Amsden, 1989; Wade, 1990; Shiratori, 1993).

At the other extreme, a number of American economists have argued that factor accumulation is the dominant—if not the only—source of the HPAEs' high growth rates (Krugman, 1994). They attribute Asia's success to policies which increased physical and human capital per worker, and dismiss as irrelevant or harmful policies designed to promote technological learning. In its extreme form, this argument asserts that the HPAEs may have compelled their societies to save and invest too much, setting the stage for an inevitable—and possibly abrupt—growth slowdown.

This essay compares the characteristics and sources of growth in the eight high performing East Asian economies and the Middle East and North Africa. It then examines four key policy lessons for the Middle East, drawn from East Asia's success.

2. The Nature of the Miracle—Rapid Growth with Equity

The HPAEs are a highly diverse group of economies, differing in natural resources, pop ulation, culture, and economic policy, but they share three characteristics that set them apart from other developing economies. First, their rapid growth in itself is unusual. On average, developing countries are not catching up to the advanced economies. But the eight high performing Asian economies are all "converging" on the high income countries. Most MENA economies, on the other hand, are falling behind. Per capita income growth has lagged those of the East Asian superstars and the high income economies.

Second, the HPAEs are an exception to recent work which suggests that growth rates for individual economies are highly unstable over time (Easterly, Kremer, Pritchett and Summers, 1993). The four tigers plus Japan rank with the handful of persistently rapidly growing economies, decade after decade in sharp contrast to the boom-to-bust cycle in MENA.

Finally, the HPAEs combine rapid, sustained growth with highly equal income distributions. The positive association between growth and low inequality in the HPAEs, and the contrast with other economies, is illustrated in Figure 3. Forty-five economies are ranked by the ratio of the income share of the richest fifth of the population to the income share of the poorest fifth and per capita real GDP growth during 1965-1989.[3] The northwest corner of the figure identifies economies with high growth (GDP per capita greater than 4.0 percent) and low relative inequality (ratio of income share of the top quintile to that of the bottom quintile less than 10). Of the nine high-growth low-inequality economies, seven are HPAEs; only Malaysia, with an inequality index above 15, is excluded.

Here, there is some good news for the Middle East. The two other high-growth, low-inequality economies identified in our sample are Egypt and Tunisia. While other MENA economies have lower growth, their income distributions are similar to those encountered in East Asia. Poverty in MENA is low compared with other parts of the world (Figure 4).

Recent work (Rodrik, 1994; Birdsall and Sabot, 1996) suggests that East Asia's more equal income distributions may have contributed to its rapid growth. If so, MENA countries have a more favorable set of starting conditions than Latin America or South Asia for resumption of sustained growth.

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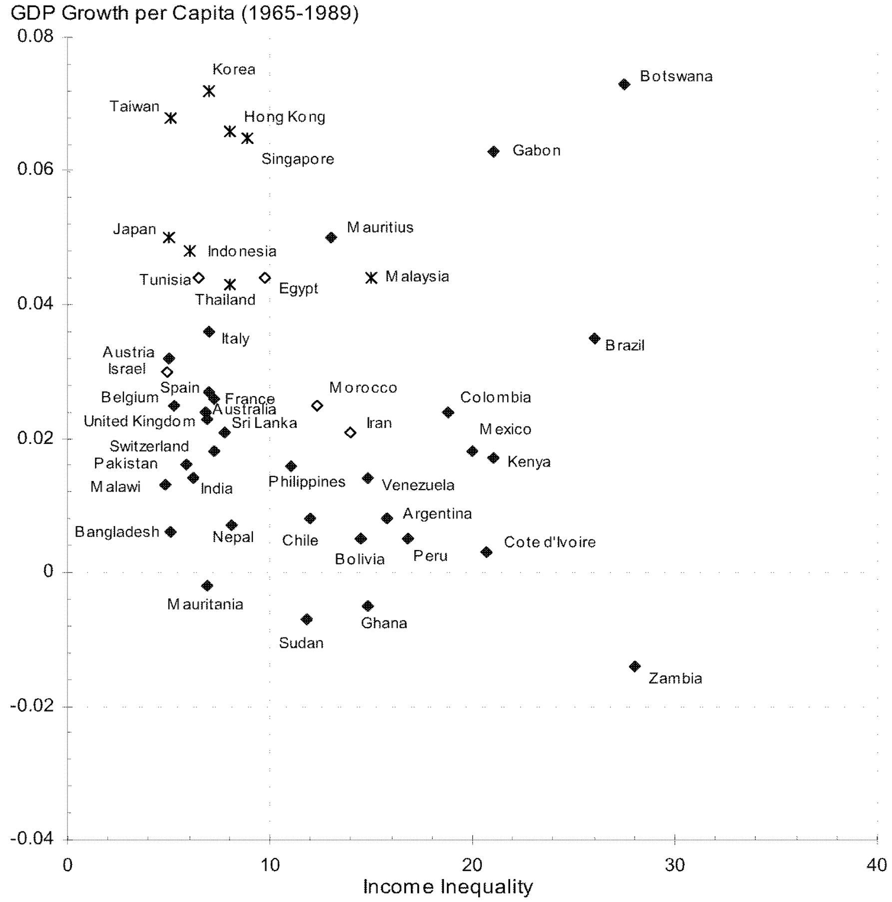
3 Because the timing and frequency of observations on income distribution vary among countries in the sample, the ratio of the top to bottom quintile is taken at the date closest to the midpoint.

3. Diverging Paths—Economic Growth in the Long Run

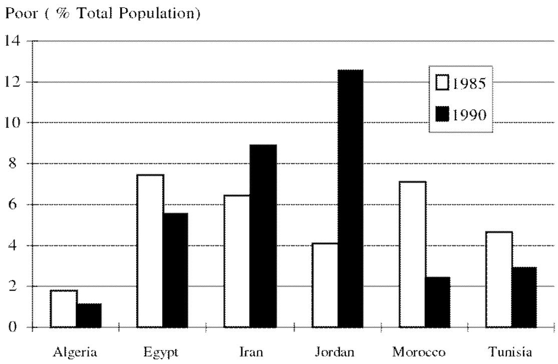
Why did growth continue in East Asia and slow down so dramatically in the Middle East? In part, differences in long-run growth between East Asia and the Middle East can be explained by differences in factor accumulation. These sources of growth—physical and human capital—are common to all economies. In part, the divergence between the two regions can be attributed to a factor almost unique to MENA—oil. What is less apparent is that oil also had an important impact on the nature of investment and therefore on another important source of long-run growth—the rate of productivity change.

Figure 3. Income Inequality and Growth of GDP, Selected Economies

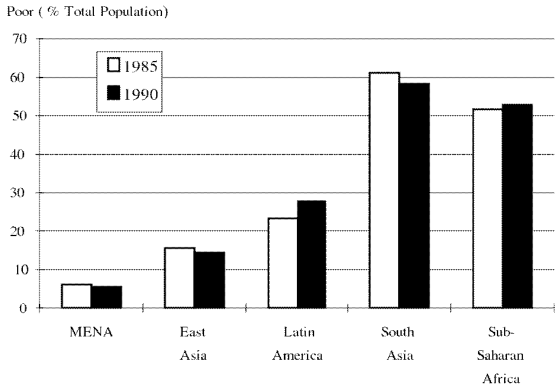


Note: Income inequality is measured by the ratio of the income shares of the richest 20 percent and the poorest 20 percent of the population.
Source: World Bank data.

Figure 4.
Poverty in MENA has been Low.....



Compared to the Rest of the World



Note: *Poor* is defined as average spending of less than $1 a day at 1985 purchasing power parity.
Sources: Van Eeghe 1995, Chen, Datt, and Ravallion 1993; Van Eeghen 1995.

The Record of Accumulation

Figure 5 shows savings and investment as a share of GDP for t he mid-1960s and the mid-1980s. While the Middle East and North Africa stack up rather well relative to other developing regions, the transformation of savings and investment in the developing-country East Asian superstars is truly remarkable. In a period of 20 years, savings and investment rates nearly doubled, exceeding all other regions by at least 10 percentage points.

Figures 6 and 7 summarize the pattern of variation of two measures of human capital. Figure 6 plots the primary school enrollment rate against per capita income, while Figure 7 shows average educational attainment over the 1960s and 1980s. The HPAEs are notable for the fact that they had both high enrollments and high levels of educational attainment as early as 1960. East Asia, in contra st with MENA, began with a sizable educational head start.

The two diagrams tell somewhat different stories about human capital formation in the MENA region. When primary school enrollment rates are correlated with relative income, the MENA economies conform generally to cross-country patterns, although Algeria and Iraq are notably negative outliers.[4]

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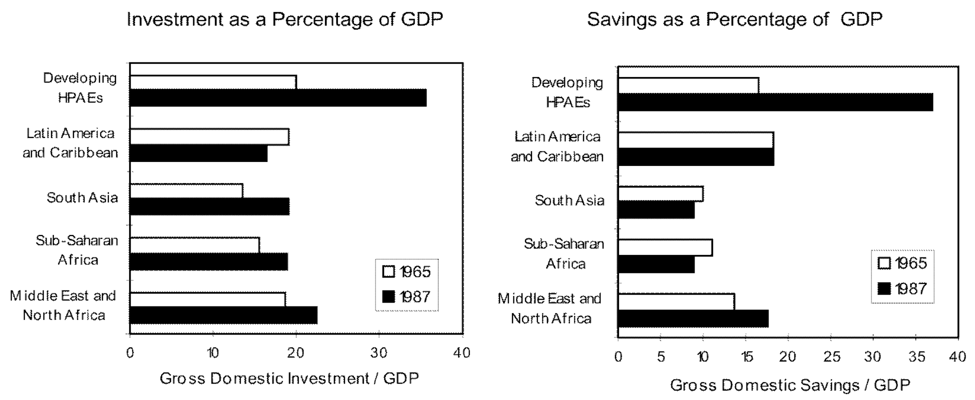
[4] The cross country pattern is found from a non-linear regression of primary enrollment rates on per capita income.

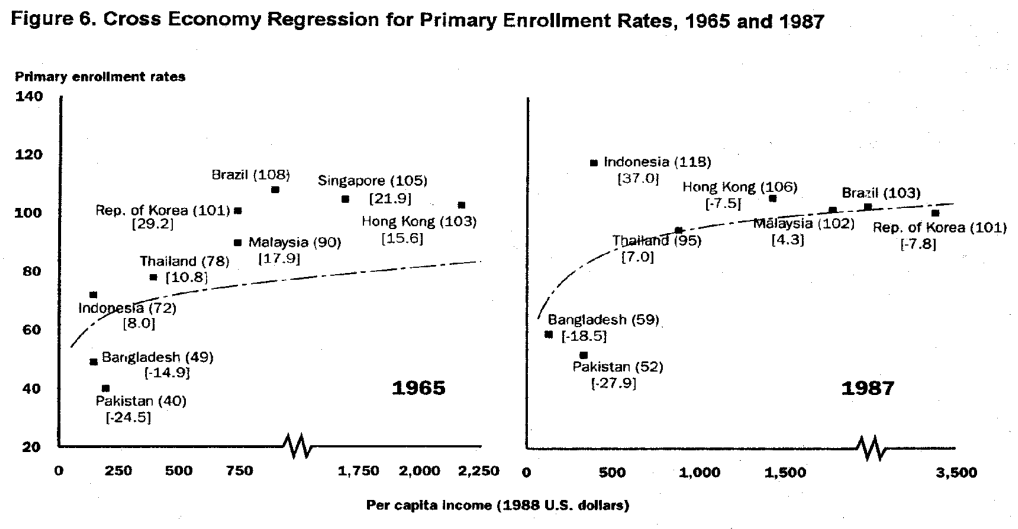
Egypt and Jordan, on the other hand, had higher enrollment rates than would have been predicted on the basis of their relative income levels in the 1960s.

Figure 5. Investment and Savings as a Percentage of GDP, Selected Economies, 1965 and 1987



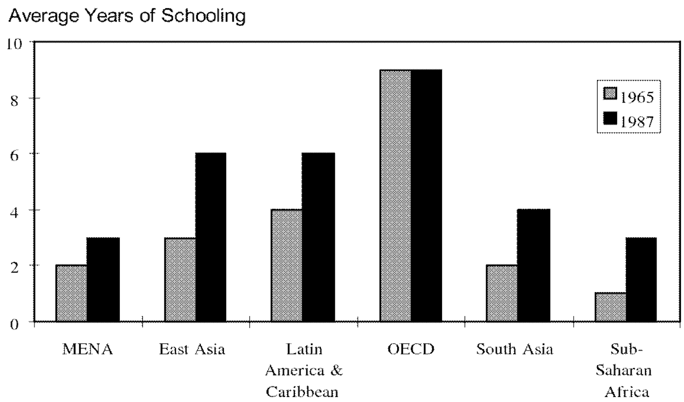
Source: World Bank data

Figure 6. Cross Economy Regression for Primary Enrollment Rates, 1965 and 1987



Note: Figures in parentheses are enrollment rates; bracketed numbers show residuals.
Source: Behrman and Schneider (1992).

Figure 7. The Middle East Still Lags in Education



Source: World Bank data.

The region underperforms quite badly, however, in terms of educational attai nment. MENA's average years of schooling per person are comparable to Africa's. The contrast with East Asia is notable. Indonesia, the East Asian economy with the lowest average education stock (and the lowest relative income), has an educational attainmen t level higher than any Middle Eastern country, despite their higher relative incomes.

At least two factors account for the differences between the region's relatively good track record on access to education and its much poorer record in terms of educati onal output. First, the rapid expansion of primary school places occurred in the late 1950s and early 1960s, which meant that the average educational stock changed only slowly between 1960 and 1985. The region was catching up from a late start. Second, high dropout rates in some countries—especially among women—also explain why increased access was not translated into increases in average years in school.

Why the Crash? Oil and the Economic Crisis

The economic crisis of the past 10 years is the product of t wo fundamental factors: collapsing oil prices and a failure to improve productivity. Oil revenues fueled the region's state -led model of economic development. Between 1973 and 1985 the rise in oil prices permitted the region's economies to increase their GDP by nearly 50 percent above the predicted trend on the basis of historical oil prices (Figure 8).

Over the 20 years from 1970 to 1990, the region had the highest rates of public investment and the lowest rates of private investment in the nonsocialist developing world. When oil prices fell in the 1980s, the region's economies were slow to adapt. Investment declined and output collapsed. Even non-oil exporters of the region, such as Jordan and Morocco, felt the ripple effects of declining oil prices through regional labor and capital markets. Recovery from the oil price shock has been painfully slow. Investment in the region is rising gradually, and projections for the next 10 years foresee modest restoration of growth.

But the region's poor performance is not entirely due to the decline in investment in the last decade. In a cross-country perspective, the Middle East's investment decline during the 1980s was not exceptional. Investment as a share of GDP was higher in the Maghreb and Mashreq than in Latin America or South Asia, and the reduction in investment rates was less dramatic (Figure 5). The collapse in performance in MENA was much greater than could easily be explained by declining levels of investment. It was the product of a dramatic decline in productivity.

Growth Differences in a Cross-country Framework

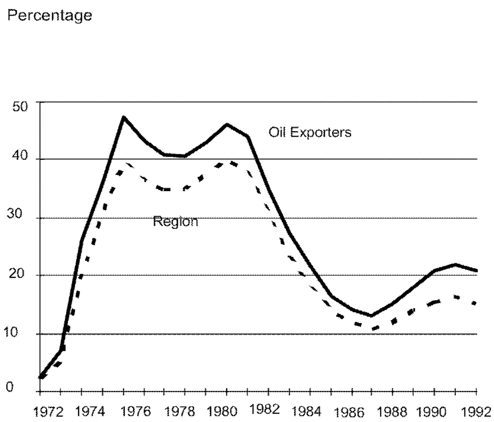
How much do differences in factor accumulation explain differences in growth? Figure 9 uses a cross-country growth regression to explain differences in per capita GDP between the eight major economies of the Middle East—Morocco, Algeria, Tunisia, Egypt, Jordan, Syria, Iran and Iraq—and the seven East Asian developing economy superstars—Korea, Taiwan (China), Hong Kong, Singapore, Indonesia, Malaysia and Thailand, over the period 1960-91. It asks the rhetorical question: if the eight major economies of MENA had the same rates of investment and educational attainment as the East Asian superstars, by how much more would they have grown? The answer, while impressive in its own right, is disappointingly small in comparison to the actual achievement of the East Asian economies.

Incomes in MENA increased from US$ 1521 per person in 1960 to US$ 3342 in 1991.[5] Raising the average rate of investment in the Middle East to East Asian levels—increasing it by 7.6 percentage points on average over the period—increases income per person in 1991 from US$ 3342 to US$ 3863. Adding to the higher investment levels, the levels of human capital in East Asia, by projecting an increase in the primary school enrollment rate in 1960 of 33 percent, results in a further increase to US$ 5179. East Asia

[5] The income figures are in constant purchasing power US dollars (Heston and Summers, 1992) of 1988 and are not comparable with nominal US dollar estimates of per capita income.

Figure 8. Past Growth Was Driven By Oil Revenues

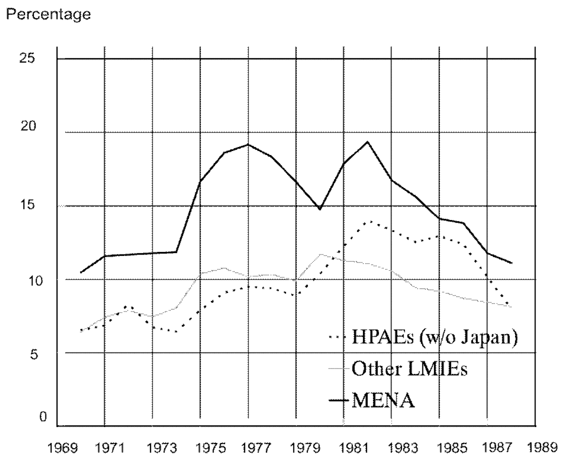
Oil Exports as a Share of Nominal GDP, 1970-1993



Note: Three-year moving average of differences between actual and counterfactual. Oil exporters include Algeria, Egypt, Iran, Iraq, Yemen, and the GCC countries.
Source: Riordan and others 1995.

and Public Investments (as a share of GDP(%))

Public Investment as a Share of GDP, 1969-1989



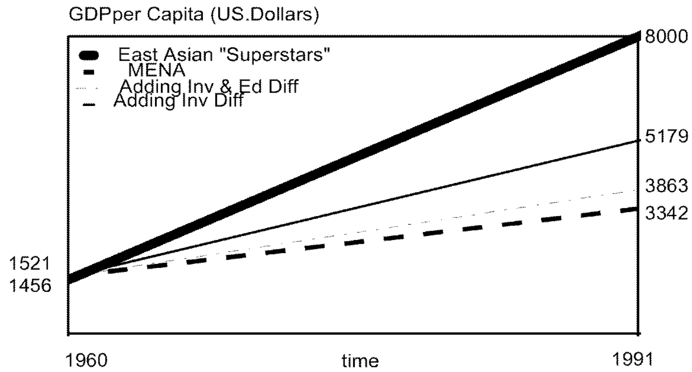
Note: MENA includes Algeria, Egypt, Iran, Iraq, Jordan, Morocco, Syria and Tunisia.
Source: Umari 1993.

over the same period grew from US$ 1456 per person to US$ 8000. More than half of the difference in growth rates (55 percent) *cannot* be explained by East Asia's superior performance in accumulating human and physical capital. Rather it is due to differences in the productivity with which capital is used.

Missing the Train: Lagging Integration with the World Economy

Most observers of East Asia agree that trade has been a major source of its productivity growth. Rising import competition and rapidly expanding exports enforced cost discipline and the search for innovation. Manufactured exports were a powerful source of lear ning, especially where there were significant buyer-seller links between advanced and developing Asian economies (Pack and Page, 1994; World Bank, 1996).

Figure 9. Investment Matters But Productivity Is Critical



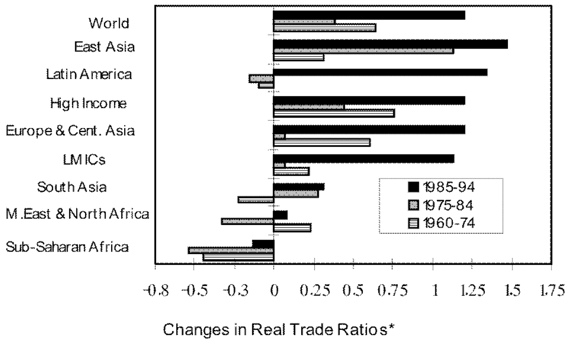
Source: Page 1995.

MENA has failed to keep pace with the changing global economy. While the sh are of trade in national income has risen rapidly in other parts of the world, especially in the last 10 years, MENA's has stagnated (Figure 10). The region trades little with itself; less than 10 percent of its trade is intraregional, a fact which has not changed since the mid-1980s. Manufactured exports per capita have stagnated. World trade in the first decade of the 21st century is projected to grow at nearly 6 percent; MENA's trade is expected to grow at 3.5 percent.

The region's economies are still quite closed. Average tariffs are high (Figure 11) and nontariff barriers remain important in some countries. Institutions to facilitate trade —customs, financial services and export promotion—function far less well than in the rapidly integrating economies of East Asia and Latin America. While Tunisia and Morocco have recently signed integration agreements with the European Union, and Egypt and Jordan are actively negotiating agreements, the slow pace of trade liberalization allowed under the European treat ies will continue to let the region lag behind.

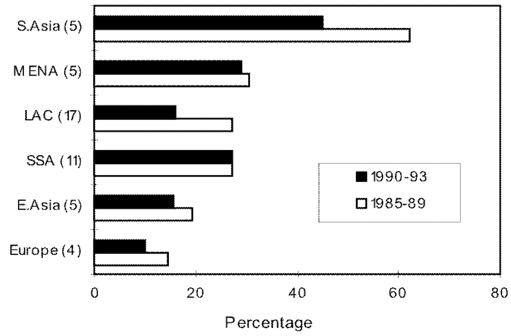
Capital flows to MENA have not kept pace with the globalization of financial markets. Portfolio investments to developing countries which grew rapidly in the 90's have primarily gone to East Asia and Latin America (Figure 12). Direct foreign investment—critical for providing technology and skills—has also been disappointing, falling in the 90's to levels comparable with Sub -Saharan Africa (Figure 13).

Figure 10.
Trade is Growing Faster in the Rest of the World



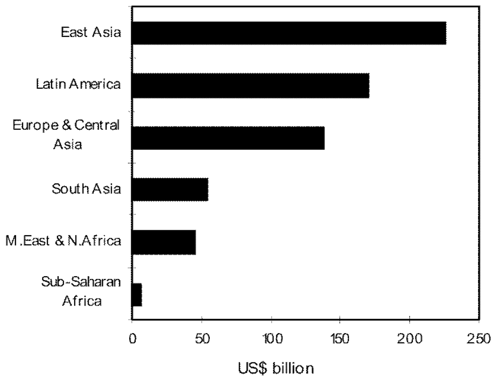
Note: * Ratio of exports plus imports to GDP.
Source: Global Economic Prospects, 1986.

Figure 11.
Average Tariff Rates are High



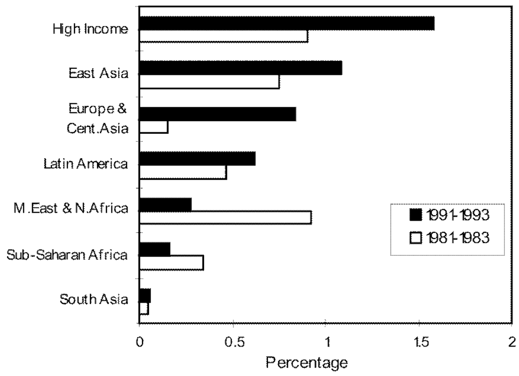
Source: World Bank data.

Figure 12.
Capital Flows Have Lagged...........



Source: World Bank data.

Figure 13.
Direct Foreign Investment has also



Source: World Bank data.

4. Choosing to Prosper: Priorities for Reform

What direction should reforms take to secure a prosperous future for the region? East Asia's experience suggests that there are two important preconditions for any growth oriented strategy to succeed—putting economics first and sharing the benefits of growth. In addition, four policy initiatives are essential: educating all the people, pushing exports, shrinking the state, and empowering the private sector.

Committing to Shared Growth

While the policy regimes of the successful East Asian countries were quite diverse, all eight pursued an important political economy objective—shared growth (World Bank, 1993; Campos and Root, 1996). In simple terms this meant that the political leadership in each country sought to legitimize its rule by asking the question: "Are you and your family better off today than last year?" This legitimizing principle meant that governments mobilized their societies to achieve rapid economic progress and sought means of sharing the benefits of growth widely. While none of East Asia's rapidly growing economies had populist regimes, governments in all eight used such devices as public investment policies, rural development initiatives, and promotion of small and medium enterprises to share the benefits of their rapid economic expansion.

Until recently, economic growth has not been a means by which governments in MENA have sought to achieve legitimacy. Now, however, the geopolitical realities of the region are changing, and governments will turn increasingly—as they are here in Egypt and in such other countries as Jordan and Tunisia—to the economic agenda. Economic growth is important, but the East Asian experience suggests that its benefits must also be perceived to be widely shared if a social consensus for pro-growth policies is to be achieved.

Educating All the People. Education is a powerful tool for sharing the benefits of growth, as well as for establishing a basis for its persistence. The region's per capita income levels—in the lower middle income range—and relatively high unskilled wages mean that sustained international competitiveness and rising incomes will depend as much on human skills as on physical investments. Indeed, more of the difference in income levels between East Asia and MENA is explained by differences in human capital endowments than by differences in physical investment.

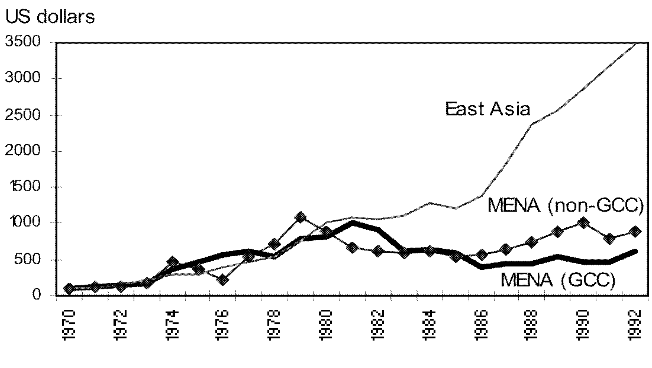
The region has done well in expanding the quantity of educational opportunities from a very late start.

With the exception of Morocco, Saudi Arabia and Yemen, all MENA countries have achieved universal primary education. Secondary and vocational education systems are less well developed, however, and there is a serious problem of educational quality at all levels. Gaps between male and female enrollment rates (gender gaps) have narrowed significantly in all of the countries, except Morocco. But today's gender gaps in MENA are approximately the same as those of East Asia in the 1960's (about 15 percent).

Because of its late start, and its limited expansion of secondary schooling opportunities, the region continues to lag in the average educational attainment of its population. Average schooling per person is about three years, approximately the same level as Sub-Saharan Africa. Increasing enrollments, demographic pressures and the need to improve quality will put severe financing pressure on the education sector. While the region on average spends about the same share of national income on education as other developing areas, both rapid economic growth and a reallocation of educational budgets from university education to basic education, especially in Morocco and Egypt, will be needed to meet the educational challenge.

Pushing Exports. MENA's non-oil exports (with 260 million people) are less than those of Finland (with 5 million people). The region's state-dominated industrial sectors, closed economies, and lagging competitiveness combine to make projected non-oil export growth the lowest, together with Africa, of all regions. Manufactured exports have lagged far behind East Asia (Figure 14).

Figure 14.
Manufactured Exports Are Not Growing



Source: World Bank data

Successful exporters in East Asia have used four critical elements which are absent in most of the MENA regions economies: Gradual, but sustained reductions in protection of the domestic market, increasing the relative incentives for investment in exports. Automatic and timely, duty free access to intermediate and capital goods for exporters, through well functioning duty draw -back and temporary admission schemes. Automatic access to export financing at competitive interest rates; and sustained attention by governments, at the highest level, to improving the institutions —from export promotion agencies to customs services—which affect the daily business lives of the export community.

None of these policy actions are beyond the capacity of MENA governments, yet none have pursued them aggressively. The free trade agreements signed by Morocco and Tunisia (and under negotiation in Jordan and Egypt) are a beginning. But they will not substantially increase market access to Europe, and their pace of tariff reduction is modest by international standards. Implementation of the European Agreements alone will not result in rapid export growth.

Reducing the Role of the State. Declining productivity over the past 30 years can be attributed primarily to the role of the state in the economic development of the region, supported by the nature of the capital inflow into the region's economies. The state dominated the economies of the MENA region in a way that was equaled only by the economies of Eastern Europe and the former Soviet Union. Except in Lebanon, the state was the primary agent for accumulating resources and allocating them to investment. The role of the state was abetted by the great importance of public official external flows in financing public investments. In addition, private external flows, mainly in the form of worker remittances, were channeled into investments in non-tradable sectors. With large portions of new investment going either into non-tradables such as housing or quasi non-tradables such as public industries protected by quantitative import restrictions, the economies of the region were ill prepared to adapt to the terms of the trade shocks of the 1980s.

The public sector in MENA remains large. Algeria and Egypt have levels of public ownership comparable to the transition economies of Eastern Europe. Morocco, Tunisia and Jordan have smaller public sectors, but the state-owned enterprise (SOE) sectors are still large compared with Latin America or East Asia (Figure 15). The state—including the public administration—bulks large in the formal labor market. The state dominates the financial sector through public commercial banks in all countries except Jordan and Lebanon.

While most MENA governments have embraced privatization of public industrial and financial

enterprises, the rhetoric far exceeds the reality (Figure 16). Governments concerned with the employment displacing potential of privatization and civil service reform—especially Egypt, Algeria and Tunisia—have preferred to avoid confrontations with public sector workers by preserving the status quo. In economies such as Algeria and Egypt, inefficient public enterprises burden the private sector by increasing the cost of goods and services inputs.

Fiscal constraints will limit further investment in industrial capacity by governments in the region, but they will also limit the expansion of infrastructure. Strategies to attract private investment in infrastructure are therefore critical. Egypt and Morocco have announced some limited concessions in power generation. Jordan is slowly moving to privatize telecommunications. But the impact of these initiatives is affected by their slow implementation and partial natures.

Empowering the Private Sector. Private capital in MENA has voted with its feet. About $350 billion in capital from the region is held abroad. Private investment rates have historically been below those in other low and middle income countries (Figure 17).

Why has investment lagged? The business environment is plagued by burdensome regulations. Egyptian entrepreneurs spend about 30 percent of their time resolving problems of regulatory compliance. Even in Morocco where substantial progress has been made, as many as 20 documents and six months are needed to register a business. Public enterprises often limit or regulatory compliance. Even in Morocco where substantial progress has been made, as many as 20 documents and six months are needed to register a business. Public enterprises often limit or prohibit entry by private competitors into the sectors they dominate. Critical infrastructure is lacking. The percentage of uncompleted telephone calls is 34 percent in Tunisia, 57 percent in Morocco, and 60 percent in Jordan. Bank intermediation margins averaged about 9 percent for the five countries you will visit, compared with 3 -4 percent in Asia and the OECD.

5. Keeping the Promise: Growth will Reduce Poverty

While accelerated growth cannot fully eradicate poverty, it can substantially reduce the nu mber of poor. Because of the "shallow" nature of poverty in the region—with many households just below the poverty line—moving from zero per capita income growth to 1 percent annual growth would reduce the number of poor in the region by 8 million over the next decade. Achieving a modest 2.5 percent per capita growth rate

Figure 15.
Public Enterprises Loom Large in MENA's Economies

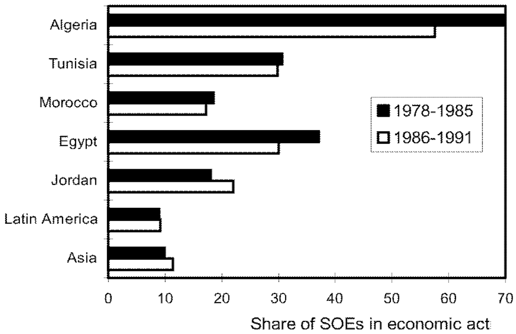
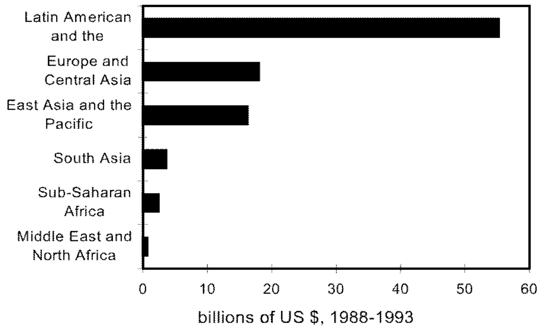
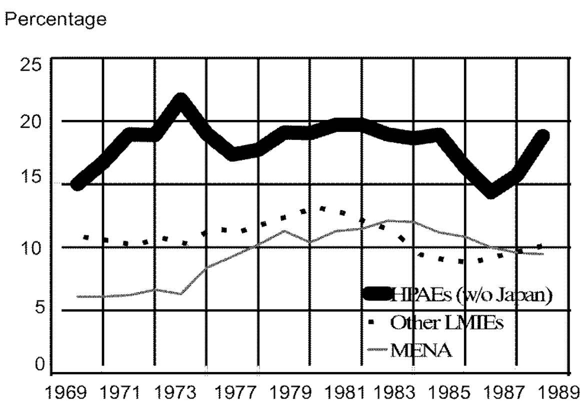


Figure 16.
Privatization Revenues Have Been Small



Note: Middle East and North Africa does not include Bahrain, Kuwait, Qatar, Saudi Arabia and UAE.
Sources: World Bank 1995, *Bureaucrats in Business*; Anderson and Martinez 1995.

Figure 17. Private Investment has Lagged



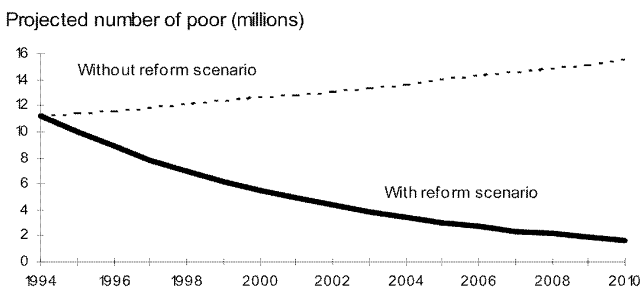
Note*:* HPAEs include Japan, Hong Kong, Republic of Korea, Singapore, Taiwan(China), Indonesia, Malaysia, and Thailand.
LMIEs = low and middle-income economies.
MENA includes Algeria, Egypt, Iran, Jordan, Morocco, Syria, and Tunisia.
Source: Umari 1993.

would dramatically reduce poverty by 2010 (Figure 18). In contrast, without the higher growth that reform can bring, the number of poor will increase to about 15 million in the same pe riod.

Empowering the private sector, attracting a reflow of flight capital, and channeling private investment into efficient activities are critical for the resumption of growth. Key elements of this process for all countries in the region are:

- accelerated privatization, to signal government commitment to private sector development and to reduce costs to the private sector of goods and services provided by the public sector;
- regulatory reform, legal reform, and reform of civil services to reduce the admin istrative burden on the private sector, secure contracts and property rights, and promote competition;
- improved supervision and prudential regulation of the banking system, increased entry of foreign banks, and privatization of state banks to promote comp etition and increase efficiency; and,
- perhaps most difficult, fostering among the civil services and political elites of the region the concept—widely held in East Asia—that effective public-private partnerships can be forged to promote rapid growth while preserving social equity.

Figure 18. Reform Will Bring Down Poverty



Note: Poor is defined as average spending of less than $1/day at 1985 PPP.
The growth elasticity of poverty used here is -4.48 .
Without reform, GDP/capita grows at -0.46 % for MENA. With reform, GDP/capita grows at 2.5%.
Source: World Bank data.

More than one million young people will enter MENA's labor markets next year. Perhaps 200,000 will find jobs; 800,000 will be unemployed—on top of the many millions who are already without jobs—and without much hope for the future. Yet this is a region close to Europe, with huge historical and natural treasures, and with an active and skilled labor force and commercial class. An economic transformation of the Middle East—like that which has taken place in East Asia—will not be easy, but it is not impossible. Political commitment and economic opening—to the world and among the countries in the region—can alter the picture and link the shores of the Mediterranean into a region of growth, cooperation and hope. There *can* be a Middle Eastern miracle.

Part II

East Asian Policy Lessons: Discussion

Following his presentation, Page responded to questions and remarks from his audience. Discussants included Said El Naggar of the New Civic Forum, Hussein El Gamal of the Social Fund for Development, Werner Puschra of Friedrich Ebert Stiftung, Heba Handoussa of Economic Research Forum, Raouf Saad from the Egyptian Ministry of Foreign Affairs, and Abdel Aziz Hegazy and Hatem Niazi from the private sector. (See appendix for a complete list of the attendees.) The following is a summary of the discussion.

Participant: One cannot disagree about Egypt's need to increase investment, savings, and productivity, and to improve the educational system, but the real issue is how. I am skeptical of generalizations and averages for the Middle East, because the region is very heterogeneous. The right policy prescription for Egypt is definitely not right for Saudi Arabia or Kuwait, and it may be different, at least in emphasis, from the right policy for Morocco or Tunisia. The most important lesson from these East Asian countries is that they grasped the meaning and implications of the great opportunities offered by the world economy, before other developing countries did, and they formed their policies accordingly.

I think three policy prescriptions should take priority at the present juncture in Egypt. First, we must move from an inward-looking strategy to an export-oriented strategy. This means to remove the great bias that exists here against export industries, and to liberalize our trade policy, which is still highly restrictive. Second, if we are serious about moving to an export-oriented strategy, we should move quickly and firmly on privatization. Public sector enterprises cannot penetrate export markets. The third policy priority is our attitude towards foreign investment. We must come to terms with foreign investment and the transnational corporation. Of course, the right macroeconomic policy is the framework for these policy prescriptions, and nothing should be sacrosanct, not even the exchange rate.

Speaker: I agree with you. But without a clearly articulated strategy towards shared economic growth, and a clear reason for the government to be in power, it is very difficult to mobilize people to act. One of the unanticipated benefits of the Middle East peace process is that it forced the governments to turn to the economic dimension of the agenda. One certainly sees it in the case of Jordan, where the king is now preoccupied with the peace dividend—something which in fact may benefit the man in the street. The

'new' government in Egypt is responding to the need to put economics much more to the front of the agenda.

Although one size doesn't fit all, I believe the region would be better off pursuing a certain desirable set of policies. I think the education systems in most countries of the region suffer from the same problems, which are basically low female enrollment rates, low cognitive skills in primary and secondary school curricula, and a delinking of the vocational system with the needs of the private sector, so vocational graduates do not have the skills to compete in job markets. Privatization is an important issue, as well, for virtually every government in the region, even those that we thought were doing well, like Morocco. How to set up an investor-friendly environment is another important issue, though it may differ from one country to another. I was in Oman recently, where the question of using the world economy is as important as it is to Egypt, because they have to diversify their economy.

I couldn't agree more with your point about trade reform in Egypt. When we try to find out why the economies of East Asia have become so successful, one of the recurrent answers is that they have been very successful because manufactured exports have facilitated technology transfer. A lot of buyer/seller relationships in manufacturing result in technology transfer. Hence their industrial sector was able to adapt.

So one should push manufactured exports. But in Egypt, nonoil exports, not to mention manufactured exports, have basically stagnated over the last 20 years, and this problem should be dealt with immediately. In Korea, an exporter is guaranteed certain things—no problems from the customs, duty free imports for export, duty free imports of capital goods. Goods are shipped in and out on time, and nobody stacks them in the back of a warehouse and ask for money to release them. They have access to credit, preshipment finance, effective private sector-oriented investment, and export promotion agencies. I don't see any country in the region with an export regime like that of Korea. We are talking about basic public administrative reform and trade policy reform. The European Union Agreement will set the framework, which hopefully will be credible, so people will believe that protection will end within about 12 years. Now is the time to start setting up mechanisms to assure exporters that they can be part of the game.

And finally, macro stability is absolutely essential, and—I won't shy away from saying it—the exchange rate *is* a critical element of that. If there are indications that exchange rate changes are needed because of underlying differences in inflation, then the exchange rate has to be adjusted. One of the great

successes of East Asia has been the ability of the governments to make the necessary adjustments in a timely fashion, so as to maintain a constant real exchange which allows investors to make long-term investment decisions.

Raising investment depends on profitability and predictability, which have to do with trade reform, the legal and regulatory structures, the predictability of the macro environment. Egypt has done better on the macro environment than on legal and regulatory reform. I think it has a way to go on predictability of the trade regime.

Participant: I have three points. First, we all agree that basic education reform is essential, but that will take some time. We cannot afford to wait for real change in the basic education system to have a positive impact on the economy. I think that the government should intervene urgently to enhance vocational training, and should perhaps make training obligatory within industry and the business community. The dual system used in Germany is being introduced here, but very slowly. With our population growth—and with 50 percent of our population under 30 years of age—we cannot wait for productivity improvement through changing the basic educational system. Businesses must have viable training centers conforming to a national standard of quality.

Some issues arise and become buzzwords, such as BOT. But I don't know whether the impact of BOT on productivity, job creation and sustainability has been researched properly. If we invest a lot in BOT, will we get the expected increase in productivity? Another issue is research and development—over the last 20 years, we have given it less than 0.02 or 0.03% of our budget. I am not suggesting that we get into basic research, but that we have a policy on applied research and development, and that new investors should make a commitment toward this. My third point is about health care. Health must have an important place in government policy if students are to benefit from education and contribute positively to economic growth.

Speaker: Sadly, reforming the educational system will only give results 15 years from now, which does put a burden on the design of more rapid and responsive vocational and adult education. However, the World Bank has generally been skeptical about these schemes, partly because the productivity enhancement which comes from vocational training is not equal to the cost of the training. My personal opinion is that, as long as there is no harm and it is not a wasteful scheme, vocational training is an important way of making sure that workers believe that the government is trying to include them in the

reform process. But it is important to link private sector demands with training. One of the reasons for success in East Asia is that government simply brokered interactions—private trainers with students—and did not get into providing vocational education itself, because governments tend to be behind the curve and can't respond quickly enough.

On the issue of BOT, I see privatization and BOT as belonging to a broad strategy to push exports into the world economy. The successful Asian economies have a range of high-quality, trade-related services in transportation, telecommunications, electrical power, and ports. Private providers can be very useful in bringing state-of-the-art technology and good management. So I would start with the trade-related services, especially telecommunications. Given Egypt's proximity to Europe, a solid, high-quality telecommunication capacity would enhance its comparative advantage. If the public sector cannot afford new technology, the private sector, in partnership with foreign investors, might be very effective in achieving some privatization and orientation to exports.

I agree with your comments on health care, which brings us back to the question of how to improve the situation with limited resources. The public sector in East Asia is relatively small in terms of expenditure to GDP, but it is highly focused on things like education and health. That suggestion may be important for Egypt, and also for other economies in the region, where the problem is quite similar. One of the possible benefits of government getting out of the operation of commercial enterprises is the increased capability to refocus existing fiscal resources on enhancing health and education. That is a policy feat that the Asian policy makers seem to have mastered better than anyone else in the developing world.

Participant: What would have happened to Taiwan's miracle if China had been a little more aggressive with it? Even in a cold peace, resources are spent on the military. Vietnam, of course, went through a war period, which subsided—but imagine if the tension didn't subside. On another matter, I am sure you recognize that in Egypt, we have to reform our judicial system. How did the East Asian countries solve their judicial problems? We hear that some countries—like Vietnam—do not have a judicial system even as sophisticated as ours.

Speaker: I have no expertise of judicial system reforms in the region, but one of the things that some observers of the business climate have highlighted in East Asia is culture, particularly among overseas Chinese. Legal contracts are not nearly as important as reputation. Many transactions carried out by the

Chinese business community are normally done on a handshake basis, yet don't require elaborate legal enforcement, because social enforcement is sufficient. If you fail to carry out a contract, you lose your reputation and nobody does business with you. So parallel systems have developed in Asia to get around problems of legal structures. I estimate that expenditure on lawyers in East Asia is substantially below that elsewhere in the world, which is good news for business.

On the question of military expenditure, it cuts both ways. For much of their rapid growth periods, Korea and Taiwan had extremely large military expenditures because both perceived serious external threats. There is no doubt that if political stability in the region begins to break down and the governments begin to spend more on the military, this would have a dampening effect on growth. But one might not mind having to worry about the rate of growth falling—as it is predicted in Singapore—from 8.3% to 8.1%. With political tensions, it might fall to 7%, which would be a deep economic crisis for the Singaporeans.

If the peace process in the MENA region is sustained, I don't think you would quickly see a reduction in military expenditure, but you will see an improved investment climate. We have already seen that in the context of the last two economic summits, which offers hope that if the peace process continues and is fair to all parties concerned, the perceptions that investors have of this region will improve.

Participant: One thing that sets the Middle East apart from the rest of the world is the size of petroleum resources as income to the countries and governments, rather than the private sector. Although oil income has come down considerably, it is still very large, which means that governments of the region are rich. In the context of liberalization, globalization, and giving more weight to the private sector, it seems that one has to continue to put a lot of weight on public investment. It is not easy for the government to channel resources directly to the private sector. One has to consider ratios, like public sector investment to GDP or public sector investment to total investment, because these could continue to be important in the region. For this reason, I would like to know more about how countries of this region could use public resources more efficiently. Also, how can contests be used successfully to promote industry?

Finally, I think that the figures for Egypt in your chart on poverty are unusually low. Moreover, poverty has worsened in the last few years, rather than improved.

Speaker: The figures that I was using are the ones used by the World Bank to make international comparisons. When you construct a poverty line, you construct it for the national economy. We use

figures on the proportion of the population living on 1 dollar a day in international purchasing power. I have no doubt that in any specific country, just as with any national data, it may be wrong in respect to levels or trends. The point is that in comparing regions, poverty in the Middle East is lower than in other parts of the world. To say more about poverty would require a lot of work that I can't do here.

Poverty in the Middle East has been brought down in comparison to Latin America and Africa, because petroleum income has been accruing to governments, and because of income transfers between governments and households. But is the current system of support sustainable? I think almost everyone agrees—perhaps with differences in emphasis—that it is not. Neither oil prices nor the generation of employment can maintain this track record, which is why in Egypt there has been concern in the last four or five years about an increase in poverty.

What can government do? I think it differs from country to country. A big issue facing most Gulf countries—Saudi Arabia, Kuwait, Oman—is how to put something aside for future generations—not whether to invest in the public or the private sector, but whether to invest now or later. There is growing recognition that national saving funds have to be replenished, otherwise they are eating up the prosperity of future generations. For countries like Egypt, Tunisia and Morocco, which are not dominant oil exporters, funds will continue to accrue to government, but there are mechanisms to choose: whether to invest in the public sector, or in a portfolio of assets abroad—which is what the Singaporean government did—or to crowd them into the private sector, through the financial system. I don't think that because you have substantial rents accruing to the public sector that you need to have large public investments.

How can you use contests? I emphasize the export contest because it is important and capable of being implemented. The best contest for Egypt is the export contest—a very rule-based contest where you are entitled to certain benefits if you carry out the transaction. The role of the referee—the government—is to make sure that you get these benefits if you complete the export transaction. One of my Latin American friends once said: We have contests and rewards in Argentina, but there are no rules or referees. So the problem of referees is not unique to Egypt.

I am far more sympathetic than the average World Banker is to the Korean and Japanese styles of industrial policies, but I firmly believe that much of their success was due to their ability to emphasize the role of the contest and to use referees. I am sympathetic towards cases where these kinds of policy succeeded, but I am skeptical of them in other contexts where those crucial elements are not in place. The US government has not been so good in implementing performance-based industrial policies when it

tried. You may remember the great fanfare about how the USA would make the car of the 21st Century, and it would be the marriage of the US space program with the three big auto makers. The auto makers quickly discovered that the referees weren't very strong, so they collected the rewards and disappeared. One has to be very careful in designing industrial policies to enforce the rules of the contest and be sure they are simple enough for everyone to follow.

Participant: I would like to elaborate on two issues. One is the role of the government, particularly how it affected the economic miracle in Asia, in the absence of full-fledged democracy, with no multiparty system, no real opposition, yet with cultures and traditions which helped lead to a kind of social pact between the state and the people. Second, you advise us to use the world economy, and here I think we must distinguish between the pre-WTO world and post-WTO. Prior to the WTO, I think the Asian countries were able to benefit from the lax, flexible atmosphere, and export as much as they wanted. Nobody kept asking them to open their markets equally. Also, technology prior and post WTO is totally different. In the past you could steal and exploit others' technology, but now we are working with tighter discipline.

Speaker: The question of whether you need authoritarian or democratic government to pursue economic reform is part of an ongoing debate among political scientists *and* economists. For each case where an authoritarian government promoted growth, you can cite one that did not, such as Mobuto in Zaire. There was a totalitarian regime that didn't achieve growth! I think one of the characteristics of authoritarian Asian governments that helped them succeed was the fact that they delegated power to important groups in society, especially to civil servants. In Korea, Singapore, Taiwan, and to a lesser extent in Thailand, governments allowed people to make decisions in managing the macroeconomy, free from political influence. They said *we will defend you as long as you do a good job*. Very few governments in the world have been willing to do that, democratic or not.

The crucial question to me, at least in the early stages of development, is not so much whether democratic forms are followed at the political level, as whether or not governments are genuinely willing to give up some of their powers in the economic sphere and allow decentralized decision making. I have seen, for example in Latin America, democratically elected governments that refused to give up any decision-making powers and that strangled economic growth. And I have seen totalitarian governments in Asia that have given up decision making powers to the benefit of growth. Looking at Egypt from the economic level rather than the political level, as long as the government is unwilling to delegate decision -

making responsibility beyond the government, even if it elects a new government with new actors, more democratic forms and processes will still not achieve very much for growth. If you are willing to make that kind of delegation, it might be good for growth without the consequent change in the democratic structure. But there are many views on this—it is a personal opinion.

Asian values are a fascinating subject. At one time, Max Weber said that China would never develop because Confucianism is completely bad for economic growth and modernism. Now everywhere I go I hear people saying that the reason East Asia is doing so well is because of Confucian values. Were the people in the past—was Max Weber—confused, or are people confused now?

That is not to denigrate the importance of culture and history—they are very important—which brings us to the question: Can you do things today in the world of the WTO that you couldn't have done in the past, or vice versa? While I think that culture and history set the context in which decisions are made, remember that North and South Korea had exactly the same cultural identity. They had, until the past 50 years, a common history. No one would argue that North Korea and South Korea have had the same economic success, so the choices that one makes within the context of culture and history are also very important.

I don't think that any part of the world is necessarily condemned to generate less growth because they don't follow Asian values. The choices within the cultural context—the kind of policies and how they are implemented—are very important. Malaysia, a very successful Islamic country in Asia, has achieved very rapid growth rates. So it is not inconceivable that one would see institutions adapted to the Middle East which would have *some* elements of the Asian story, yet would look totally unlike the ones in Asia, because they came out of different cultures and historical contexts.

In terms of learning how to be effective in the world economy and a WTO-friendly environment, we should look again to the emerging economies in Southeast Asia. The trade regimes facing Korea, Taiwan, Hong Kong and Singapore were basically WTO unfriendly—and very different from those one sees today facing Indonesia, Malaysia, Thailand, Vietnam or China. Those folks are dealing with a world economy where the rules have changed, and they are dealing with it quite successfully. One of the things they are doing is giving extremely focused support to the export community. That's one of the key elements of the successes of Indonesia, and Malaysia, to the extent that when the president of Indonesia became frustrated with his customs service, he replaced them with a foreign private operator for five years to make the customs regime work effectively for the export community. It is that kind of

intervention in Southeast Asia which seem to me to guide their desire to conform to the world trade system. They really wanted to be aggressive in moving into export markets and using the opportunities available.

My overall feeling is that the European agreements in themselves won't do very much for this region—it depends on what the governments will make of them, and that is dependent on what set of policies you build around these agreements to enhance market access. Some of my coll eagues look at the world trading system and argue that the WTO is actually good for the developing countries. The trade environment for Korea, Japan and Taiwan was actually much more hostile in the sixties and seventies than it is today for a country trying to get into the world economy.

Participant: I find your analysis quite illuminating about the conditions of the East Asian miracle, and also about how to apply some of the lessons from East Asia to this region. What I especially like is your combination of economic analysis and political economic considerations. These are very important indeed. I think one of the major factors of success in East Asia is that government assumed the leading role in promoting economic development. In Korea, when the military regime took over in 1961, the military general didn't understand anything about economics, but he said he wanted 2 -digit growth for the country, and he wanted the civil servants and technocrats to do everything possible to achieve it. He visited companies each week, and prizes and rewards were given to the best performers each month, and so on. The government also developed the statistical system needed to keep track of the achievements.

On the issue of savings, I think you were right when you said growt h led savings. You also said we don't know what makes people save more. But that is an important question. In Korea, real incomes increased for three decades uninterruptedly. That means that people each year had higher income, and they got used to it after some time and believed that each year they would have more income. But they didn't consume more, and the marginal saving rate increased. I don't think it was the interest rate policy because interest on savings was mostly negative in real terms. On the ot her hand, there were very restrictive consumption policies, such as the exchange rate; which was undervalued, so people didn't consume much in terms of imports. The Koreans were not allowed to travel abroad without permits; they were not allowed to own cars until the late eighties. Consumption was really restricted. Is this feasible for this region, which has completely different consumption patterns? Beside the restriction elements, there were also positive elements to increase savings. I think one importa nt element is the social security system, especially the pension system, based on capital accumulation. That really made people save in

order to have something for their old age, especially in times of rapid industrialization and urbanization when traditional rural links break down.

I would really be interested in knowing what kinds of saving policies you would recommend for this region. I would like also to comment on the issue of government. You may not need a totalitarian government, but you need a strong government. But what constitutes a strong government? Two elements: legitimacy and participation; as you said. That means that even when we look at the East Asian political terms, we find the governments were surprisingly open, and legitimized themselves through social development and economic success. They didn't neglect the social side, which is so important. There were means and channels of participation, so the interaction between the government and the society was there. The government was not restricted as one may think when we look at the military and totalitarian characters.

Speaker: I would really like to comment on your question about what saving policy to adopt. I agree with you fully—this comes back to the question of culture and history. I don't believe that some of the more restrictive tools used by the Japanese and Korean governments for restricting consumer behavior targeting would work in Arab societies and certainly not in Egypt. So where would you start? As you say, I think some of the institutional mechanisms governments developed to take savings which were in the economy, but not in the formal financial sector, and to get them into the financial sector, are very important. For Egypt, I certainly look at the question of rural savings. I suspect that there are far more savings in the rural economy than are getting into the financial system, and that is in part because of the transaction costs of getting to the bank and making deposits. We know that Japan, Taiwan and even Southeast Asian countries used such things as postal saving systems, the regulatory authorities' powers to encourage branch banking, and other things, to transform nonfinancial savings to financial savings, and increase efficiency.

I agree with you that the interest rate policy is not the key. All the evidence we have suggests that once you achieve positive real interest rates on deposits, the response of deposits to further increases is not terribly large. That suggests that one has to look to other means.

Finally—to go back to one of the other questions that was asked—it also has to do with demographics. The rapid demographic transition in Asia was one of the things that caused a bubble in savings because of the change in age profile. Household formation increased very rapidly and then came

to a halt. So for a period, there was an increase in the number of households *and* savings. I agree that the bottom line is that if you get growth going at 6 or 7% per year, you will see savings coming up.

The final element would be public sector savings. I think public sector savings for the Middle East (and also for Latin America) are going to be very important during the next 10 years. Increasing public savings, which in a sense means reducing public expenditure, can be very benefici al in the short run. When you need to have more savings in the economy, but you don't have the medium -term mechanisms in place to raise them in the households, you raise them in the public sector. Again, that is what one does with privatization, cutting off budgetary support to public enterprises.

Participant: I would like you to comment on population growth and its effect on income distribution and economic growth, because this is definitely a problem in Egypt. We have 4.5 or 5 million civil servants in the government alone, and some studies say the figure on poverty is not less than 25%. Also, where did East Asia put priority? Should we give priority to in-house reform, or to following international institutions, and gaining direct foreign investments and the support of the international community? **Speaker:** Population growth is invariably going to limit your per capita income increases. It is just a simple fact. The demographic transformation in East Asia was very rapid, to the extent that now they worry about depopulation as in the OECD countries. It is, again, culture and history. It is more difficult to think about effective programs to manage population growth in this region, than it was in Asia, but it certainly should be a major element for the gover nments in the region.

Is in-house reform more important than the support of the international community? I think yes, absolutely. The critical decision point for Korean economic policy was realizing that they had to adapt to the proposed reduction in US aid. One of the things that concerned me in our discussion last week about the European-Mediterranean agreement was that to some extent, I sense a policy perspective in the government here which says well, these agreements are very well , but the central be nefit to be gotten from them is increased aid flows. I would rather see people say, the central benefit that we will get from this is the chance to change ourselves, and the aid flows are icing on the cake. The aid flows may make it possible to change in an easier fashion, but if maximizing aid flows becomes the objective, then I think the central benefit of the agreement is lost. I think the lesson from East Asia is very clear. It was home - cooked economic reform, and again, because they have been adept man agers, they managed the international community to their benefit once they formed their views of what they want to achieve. It isn't that they managed their domestic reform process for the benefit of the international community.

The shifts in the working population are facilitated by how well the labor market works. And labor markets in East Asia worked very well, because they were very flexible. I think we are starting to see a somewhat more careful approach on the part of Asian governments to protecting the rights of workers in certain activities, which brings them closer to OECD norms, at least North American norms. Hopefully, in MENA, we see a recognition that governments went too far in the other direction. They spent too much effort protecting the ri ghts of workers, and forgot about the employers who have to make hiring decisions. Even if one was successful in encouraging the growth of non oil exports in the private sector, whether or not that benefit transfers to the whole economy depends on how flex ible the labor market is, how easy it is for people to move from one occupation to another. Right now in Egypt, we are dealing with two distinct labor markets, one in the private sector and one in the public sector. My guess is that not much spillover will take place from the private sector to the public sector. Maybe quite a bit of labor is moving in the opposite direction, but all of these issues are coming to the forefront now. The success of beginning to open up the economy is in meeting those challenge s.

Appendix

List of Attendees

Nadia Abdel Azim
Undersecretary, Ministry of Economy

Gouda Abdel Khalek
Professor, Faculty of Economics & Political Science, Cairo University

Mostafa Abd-El-Latif
Economist, Egyptian Center for Economic Studies (ECES)

Mamdouh Badr El Din
Chairman, Tico Badr

Adel Bishai
Chairman, Economics Dept., American University in Cairo

Paul Clark
Consultant

Paul Deuster
Associate Director, Office of Economic Analysis & Policy, USAID Cairo Mission

Willem Errens
Social Fund for Development

Ahmed Ezz
Chairman, Ceramica El Jawhara

Hisham Fahmy
Deputy Director & Director of Administration, Communication & Finance, ECES

Hala Fares
Economist, ECES

Mai Farid
Research Assistant, ECES

Nagui El Fayoumi
Advisor & Special Assistant to Associate Director for Trade & Investment, USAID Cairo Mission

Ahmed Galal

Executive Director & Director of Research, ECES

Hussein El Gamal
Program Officer, Social Fund for Development

Maisa El Gamal
Program Officer, Economic Research Forum

Samia Guirguis
Assistant to Resident Representative, UNDP

Heba Handoussa
Managing Director, Economic Research Forum

Abdel Aziz Hegazy
Abdel Aziz Hegazi & Co. Accounting & Management Consultants, Cairo

Taher Helmy
ECES Board Chairman, and Partner, Baker & McKenzie Law Firm

Hala El Khamissi
Research Analyst, ECES

Ahmed Osman El Kholy
IDC

Samir Korayem
Consultant

Robin Lamb
Head of Political & Economic Section, Embassy of the United Kingdom

Patrice Lord
Editor & Publications Coordinator, ECES

Ashraf Mahmoud
Senior Vice President, Al Ahly for Development & Investment, Cairo

Mahmoud Mohieldin
Senior Economist, ECES, and Professor of Economics, Cairo University

Judith Morsy
Technical Assistant for Sector Policy Reform, USAID Cairo Mission
Hatem Niazi Moustafa
Chairman, Nimos Group

Said El Naggar
President, New Civic Forum

Werner Puschra
Resident Representative, Friedrich Ebert Stiftung

Amal Rifaat
Economist, ECES

Raouf Saad
Deputy Assistant to the Minister of Foreign Affairs

Thomas Scheben
Director, Konrad Adenauer Foundation

Nabil El Shafei
Head of Economic Unit, National Center for Middle East Studies

Youssef El Sharnoubi
Board Member, United Engineers

Yasser Sobhi,
Journalist, Economic Section, Al Ahram

Arvind Subramanian
Resident Representative, International Monetary Fund, Cairo

Hady Tarrab
General Manager & Owner, Carlin Middle East Co.